DEPARTMENT OF STATE REVENUE

04-20170602R.MOD

Memorandum of Decision: 04-20170602R
Gross Retail and Use Tax
For the Year 2013

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Memorandum of Decision.

HOLDING

Insurance Company was not entitled to a refund of use tax paid on the purchase of prewritten computer software purchased from various vendors and utilized in part by Insurance Company's Indiana employees; Insurance Company was not entitled to a refund of tax paid on the purchase of software maintenance agreements because Insurance Company failed to establish the underlying software was exempt or that the agreements did not call for the provision of updates, patches, or "fixes."

ISSUES

I. Gross Retail and Use Tax - Prewritten Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-3-2(e); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-3-14(2); 45 IAC 2.2-3-16 (repealed); 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a); Sales Tax Information Bulletin 8 (November 2011); Sales Tax Information Bulletin 8 (July 1, 2018).

Taxpayer argues that the Department erred in denying it a refund of tax paid on the purchase of prewritten computer software claiming that the software was accessed and used by many of its employees located outside Indiana and - in some instances - housed on computer servers located outside the state.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

Authority: IC § 6-2.5-1-14.5; IC § 6-2.5-4-17; *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, (Ind. Ct. App. 1974); Sales Tax Information Bulletin 8 (November 2011).

Taxpayer maintains that it is entitled to a refund of sales/use tax paid on the purchase of software maintenance agreements on the ground that the software is utilized both within and without Indiana or that the maintenance provider did not supply computer updates, fixes, or any other tangible personal property during the term of the agreement.

III. Gross Retail and Use Tax - Exempt Service Transactions.

Authority: 45 IAC 2.2-4-2; 45 IAC 2.2-4-2(a).

Taxpayer states it is entitled to a refund of use tax paid on exempt, service-only transactions.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which provides individual insurance policies, retirement plans, and group insurance policies. Taxpayer submitted a refund request seeking the return of approximately $180,000 of use tax paid on the purchase of prewritten computer software, maintenance agreements, and service-only transactions.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's claim and denied the refund.

Taxpayer disagreed with Department's decision denying the refund and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Memorandum of Decision results.

I. Gross Retail and Use Tax - Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that it was entitled to a refund of use tax paid on the purchase of prewritten computer software on the ground that the software was hosted by vendors on computer servers that were located outside Indiana.

A. Taxpayer's Burden in Claiming a Refund.

When a taxpayer challenges taxability in a specific instance, the taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

B. Indiana's Gross Retail Tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). "When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser . . . occurs . . . ." IC § 6-2.5-13-1(d)(2).

C. Indiana's Complementary Use Tax.

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). However, Indiana's use tax - not sales tax - allows an exception for the "temporary storage" of tangible personal property delivered into Indiana but destined for use outside the state. IC § 6-2.5-3-2(e).

D. Computer Software and Indiana's Sales/Use Tax.

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax:

> "Tangible personal property" means personal property that:
> (1) can be seen, weighed, measured, felt, or touched; or
> (2) is in any other manner perceptible to the senses.
> The term includes electricity, water, gas, steam, and prewritten computer software.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

> A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software.

E. Sales and Use Tax Exemptions.

As a general rule, all purchases of tangible personal property - including computer software - are subject to sales

or use tax unless specifically exempted by statutes or regulations. 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a). Various sales tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are also generally applicable to use tax. 45 IAC 2.2-3-14(2).

A statute which provides any tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

F. Taxpayer's Software Purchases.

In this instance, Taxpayer purchased and used prewritten software to conduct its business. Taxpayer argues that it is entitled to a refund of use tax paid on the purchase of prewritten software because the software is housed on servers located outside Indiana. Taxpayer explains that it is entitled to an apportioned amount of the tax based on the number of its employees located in Indiana and the number of its employees who are located outside Indiana.

For example, Taxpayer purchased computer software from Qualys, Inc. paying the vendor approximately $17,000. Taxpayer seeks a refund of 56 percent of the use tax attributable to this purchase on the ground that only 44 percent of the employees accessing this software are located in Indiana.

In its original review of the refund claim, the Department explained:

> The majority of the software invoices showed tangible personal property was *shipped* to Indiana. The remaining invoices did not have a ship to address, but the *bill to* address was in Indiana. (*Emphasis added*).

In a response to the Department's request for additional information justifying the refund:

> The [T]axpayer provided a signed statement from the Assistant Vice President of [Taxpayer] stating the percentage of software licenses used outside Indiana. The [T]axpayer did not provide the additional information showing the percentages were calculated or any other support to substantiate the claim.

Taxpayer argues the software at issue, including the Qualys, Inc. software, functions as a "service" accessed electronically by users within Indiana and outside Indiana. In those cases, Taxpayer seeks a refund of 100 percent of any use tax paid on those purchases. Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, in effect at the time of these 2013 transactions, speaks to the contrary.

> Prewritten computer software maintained on computer servers outside of Indiana also is *subject to tax when accessed electronically via the Internet* (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.
>
> Example 3: An Indiana resident purchases a new computer that enables the purchaser to access prewritten computer programs maintained on a third party's computer servers located outside of Indiana. The purchaser never receives the software in a tangible medium. Instead, the purchaser's software, including any documents created with the software, is housed on the third party's server. *The sales of these programs are subject to tax.*

(*Emphasis added*).

The Sales Tax Information Bulletin 8 (July 1, 2018) is clear on the applicability of the 2011 bulletin:

> [T]ransactions involving remotely accessed software occurring prior to July 1, 2018, will need to be analyzed using guidance published in the prior version of this bulletin.

In its protest, Taxpayer seems to be relying on Indiana's former "Multiple Point of Use" (MPU) statute, IC § 6-2.5-13-2 but it cannot do so because that statute was repealed in 2009.

Alternatively, Taxpayer would seem to rely on the "temporary storage" exception found at IC § 6-2.5-3-2(e). However, the Department finds that particular exception inapplicable because Taxpayer typically paid a unitary

price for each single software package. Although that single software package may be ultimately utilized by multiple users in multiple locations, the Department finds no support for the proposition that Taxpayer can now reallocate the unitary use tax paid based on the ultimate number of software users located within and outside Indiana. IC § 6-2.5-3-2(e) applies the exemption to "property" and contains no provision allowing the apportionment of the use tax due on "property" Taxpayer purchased and then first "used" in this state.

In this case, the Bulletin is clear; the purchase of remotely accessed prewritten computer software is "tangible personal property" and subject to Indiana's sales/use tax. Equally clear is IC § 6-2.5-13-1(d)(1) which provides that "[w]hen the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). In this case, the Department does not agree that payments to the software vendors are exempt from Indiana's sales or use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail and Use Tax - Software Maintenance Agreements.

DISCUSSION

The issue is whether Taxpayer has provided sufficient documentation to establish that it is entitled to a refund of use tax paid on the purchase of software maintenance agreements.

Taxpayer seeks a refund of use tax paid on the purchase of software maintenance agreements. Taxpayer explains that it "purchased various maintenance agreements and extended warrant agreements where no updates were actually received."

In its initial review of Taxpayer's refund, the Department requested that Taxpayer provide "[d]ocumentation showing that no property was transferred under the maintenance agreement[s] . . . ." In its final report, the Department indicated that "[T]axpayer did not provide any additional information regarding the maintenance agreements."

IC § 6-2.5-1-14.5 defines "Computer software maintenance contract" as "a contract that obligates a person to provide a customer with future updates or upgrades of computer software."

Indiana law, IC § 6-2.5-4-17, further provides:

> A person is a retail merchant making a retail transaction when the person enters into a computer software maintenance contract to provide future updates or upgrades to computer software. (*Effective July 1, 2010*).

However, Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, provides that a taxable maintenance agreement is necessarily coupled with the transfer of "tangible personal property."

> The term "computer software maintenance contract" means a contract that obligates a person to provide a customer with future patches, updates, upgrades, or repairs of computer software.

Taxpayer has not provided information necessary to determine that - during the term of the subject maintenance agreement - the vendors provided no software updates, patches, or "fixes." For example, Taxpayer has not provided copies of the written agreements between itself and the subject agreement vendors. Instead, Taxpayer relies on its "say so" that the price paid the vendors is exempt from use tax. The Department assumes no bad faith on Taxpayer's part but, the Department is mindful of the rule that "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974. The Department is unable to agree that a taxpayer's bare assertion as to the taxability of its maintenance agreements is sufficient to warrant granting a refund of use tax when there is no documentation to buttress that assertion.

FINDING

Taxpayer's protest is respectfully denied.

III. Gross Retail and Use Tax - Exempt Service Transactions.

DISCUSSION

The issue is whether Taxpayer has established it is entitled to a refund of use tax paid on the purchase of service contracts.

In its initial response denying that portion of the refund, the Department stated in its March 2017 explanation that, "[B]ased off the invoices provided by the [T]axpayer, it could not be determined that the items were professional services. Instead, these items appear to be tangible personal property sold at retail . . . [and] the [T]axpayer did not provide any additional information showing that these items were services."

Taxpayer argues that it was incorrectly denied a refund of tax paid on its purchase of these exempt services.

Taxpayer relies on 45 IAC 2.2-4-2 as authority for its position that these purchases are exempt from sales/use tax.

45 IAC 2.2-4-2 provides as follows:

> (a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
>
> (b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.
>
> (c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.
>
> (d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

As to the following payments, Taxpayer has provided documentation which is sufficient to meet its burden of establishing that the transactions were one for which Taxpayer was purchasing and paying for exempt services.

- DST Technologies, Invoice INV0016235A, December 24, 2013;
- DST Technologies, Invoice INV0016235B, December 24, 2013;
- Novatus Contract Management, Invoice 2013-1600, September 25, 2013.

Taxpayer has met its burden of establishing that it is now entitled to a refund of tax paid on the transactions listed in Part III.

FINDING

Taxpayer's protest of the three (3) transactions is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest is sustained, in part, and denied, in part. Taxpayer's protest

of the three (3) transactions under Issue III is sustained. However, the remainder of Taxpayer's protest is denied.

December 31, 2019

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